QUEENSLAND FARMERS' FEDERATION

QCA Draft Report

SunWater Irrigation Price Review: 2012-17
Volumes 1 and 2

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Queensland Farmers' Federation (QFF) is the peak body representing and uniting 16 of Queensland's rural industry organisations who work on behalf of primary producers across the state. QFF's mission is to secure a sustainable future for Queensland primary producers within a favourable social, economic and political environment by representing the common interests of its member organisations'. QFF's core business centres on resource security; water resources; environment and natural resources; industry development; economics; quarantine and trade.

Our goal is to secure a sustainable and profitable future for our members, as a core growth sector of the economy. Our members include:

- Australian Prawn Farmers' Association,
- CANEGROWERS,
- Cotton Australia,
- Growcom,
- Nursery and Garden Industry Queensland,
- Queensland Chicken Growers Association,
- Queensland Dairyfarmer's Organisation,
- Queensland Chicken Meat Council,
- Flower Association of Queensland Inc.,
- Pork Queensland Inc.,
- Biological Farmers of Australia
- Fitzroy Food and Fibre Association,
- Pioneer Valley Water Co-operative Limited,
- Central Downs Irrigators Limited, and
- Burdekin River Irrigators Area Committee

Thank you for the opportunity to make a submission on the Draft Report SunWater Irrigation Price Review: 2012-17 Volumes 1 and 2. QFF was unable to attend all consultations so comments in this submission relate to overall issues affecting the river schemes and the distribution schemes including their bulk segments. QFF would like the opportunity to review individual scheme submissions and follow up in January on any specific issues that may warrant further attention.

River schemes

Most river bulk schemes accepted QCA price recommendations which were lower than their current prices as a result of the shift to a higher fixed tariff and the approach adopted to allocate asset renewals and fixed operating costs between medium & high priority. QCAs recommended prices for each scheme vary but all but one scheme are less than the 2011-12 price after allowing for CPI. For example, in the Callide scheme recommended prices are 31% below their current prices, Upper Burnett & Barker Barambah schemes are 28% below, Boyne 18%, Upper Condamine 16%, Three Moon surface 16%/groundwater 3%, Proserpine 19% and Chinchilla 10%. The exception is the Macintyre Brook scheme near Inglewood where annual prices are increased by QCAs maximum of $2 plus CPI and the 2016-17 prices is still $2.71 below the cost reflective price.

The significant issues for river schemes are as follows:

Tariff structure – QFF has supported the principle that tariffs should reflect fixed and variable costs however there have been concerns raised at consultations about the implications of high fixed charges during periods of low water availability. QCA has left this issue for governments to address. It will be important to keep the implications of implementing high fixed tariffs under review particularly in those schemes that face limitations in water availability annually and possibly also on a seasonal basis, record low average water use and have poor water trading results. Schemes may also be subject to the implementation of water planning reforms such as the Callide which could mean changes to prices once plan reviews are implemented.

Overall, these bulk schemes were surprised at the levels of return that they are now paying to SunWater as a result of the State Government's decision to maintain revenue levels. A number of schemes raised questions about the differences between cost reflective and recommended prices.

Renewals annuity – QCA recommendations in regard to actual and forecast renewals need to be reviewed for those schemes that make submissions concerning their opening negative balances and the poor standard of SunWater consultation in regard to past and forecast renewals programs. These issues are compounded by the poor quality of the SunWater network service plans and the subsequent failure by SunWater to release adequate scheme data for efficiency reviews by QCA and their consultants. Further comment will be made in regard to these issues in the recommendations section later in this submission.

Operating costs – SunWater has failed to provide adequate data to explain the high levels of operating costs and in particular indirect and overhead costs in the bulk schemes. QCA analysis has been unable to adequately assess cost efficiencies despite funding a number of consultant investigations. Substantial resources have been wasted trying access SunWater's data to conduct a reasonable analysis of these costs. There is little confidence that QCA has completed an adequate analysis of SunWater operating costs and cost forecasts. Processes must be put in place over the new price path to ensure this problem does not reoccur with every subsequent 5 yearly price review. There will be further discussion and recommendations made in the following section on the distribution schemes.

Distribution schemes (bulk and distribution segments)

The distribution schemes face significant issues which require urgent attention by both the State Government and QCA before QCA finalises its report.

Scheme consultations raised concerns about a range of issues addressed in the draft scheme reports. Significant issues included:

a) Recommended bundled price paths will be a significant impost in most distribution schemes. For example recommended prices in the Lower Mary and Bundaberg increase by 51% and 45% respectively on current prices to over $110/ML. Theodore and Eton increase of 20% and 29% respectively to over $90/ML.
b) Recommended bundled prices at the end of the price path are still well below the cost reflective prices in many schemes eg Lower Mary ($62.35/ML), Theodore ($28.35/ML), Eton ($16.54/ML) and Bundaberg ($6.55/ML)
c) Above the average water use in each scheme is penalized with higher prices. This will discourage increased use to reduce prices into the future and is of particular concern in the very low usage schemes such as Lower Mary 43%, Bundaberg 47% and Eton 55%.
d) Very high termination fees payable to trade water out of distributions to river segments will stifle trade and lock customers into distribution schemes which are the areas that are struggling to meet the cost. Distribution irrigator's are questioning what they own as the proposed exit fee exceeds the current value of their water allocation entitlements.
e) Very high indirect and overhead costs in bulk and distribution schemes. Up to 61% of total costs excluding Renewals Annuity.
f) A significant negative renewals balance in many schemes which in most cases is the result of large over-budget spends on renewals without adequate consultation with customers.

g) Scheme specific issues such as loss of declining block tariff in Mareeba, significant free water allocations in the Burdekin, allocation of actual electricity costs in Bundaberg and new water issues which are caused by bags on weirs, distribution lining and Paradise Dam.

h) Overall most distribution schemes expressed concern about the impact of these recommendations on irrigation customers and the viability of schemes. They also questioned how distribution schemes would meet future burdens such as metering upgrades and increasing SunWater overheads and other operating costs. Questions are also being raised in regard to SunWater's abilityto meet any operational cost targets set by this review when all other targets set in previous reviews have ballooned out and have been passed onto water users in the next price path.

The following outlines a number of recommendations to reduce costs/prices and to put all distribution schemes on a sustainable footing. These recommendations also apply in some respects to river schemes.

1. Model reviews

It is questioned whether the QCA and SunWater pricing models correctly analyse and allocate costs and revenues. A number of specific issues have been raised in the scheme consultations which include:

- Using a twenty year period to assess electricity costs will over recover these costs over the next five years
- Each distribution scheme has a number of revenue sources which must be offset against costs. It is unclear whether QCA has accounted for all revenue sources which include drainage and drainage diversion charges and minimum charges for small users. It is questioned whether a charge has been levied for delivering river water through distribution infrastructure which occurs in a number of schemes and in some cases major non irrigation users requiring high priority access. In this case it has also been questioned how this charge should be assessed. For example distribution customers pay for the cost of 100% of the distribution to deliver their allocations whereas bulk customers who use distributions to deliver their water should pay for the proportion of the distribution to deliver their maximum requirement. Revenue offsets must also be escalated by CPI.
- There is still some clarification required in the distribution schemes about what are bulk works and distribution works.
- The allocation of indirect and overhead costs between bulk and distribution segments also needs to be checked.

Recommendations: Conduct independent reviews of both the QCA and SunWater pricing models to check whether appropriate methodologies have been used. In particular, the following issues need to be checked:

- ***Electricity costs are assessed over a five year price path as a twenty year period of assessment will over recover costs for the next five years.***
- ***Revenue items for each scheme are allocated correctly and offset against costs. CPI must also be applied annually.***
- ***Allocation of asset costs between bulk and distribution service contracts***
- ***Allocation of indirect and overhead costs between bulk and distribution service contracts***

2. Distribution losses

QCA is recommending that prices reflect the cost of 100% of losses allocations in distributions but actual losses only take up a portion of these allocations e.g. Mareeba actual losses are less than 70%

of allocated losses, Eton 60%, Burdekin 53% Lower Mary 50% and Bundaberg 23%. Also the losses in the bulk segments (called transmission losses) do not incur any costs. If this distinction continues to apply then the unused portion of distribution losses should be made available for use to those customers that have paid for this cost allocation. The use of high priority losses to fill distributions is also questioned as the only time channels would get filled to provide for high priority losses would be when the announced allocation for medium priority was zero.

Recommendations:

- ***QCA adjust recommended prices in their final report to take account of actual losses assessed using the largest recorded distribution loss allocation over the last eight years. If carryover of allocation is allowed in the specific scheme, the losses allocation for carryover should also be included in the assessment.***
- ***Subject to the availability of improved bulk metering, DERM should review bulk and distribution losses in each scheme over the term of the new price path to determine and account for actual losses.***
- ***A detail assessment of the need for high priority losses water allocation entitlements in each scheme to be carried out by DERM.***

3. Termination fees

Customers wanting to exit or stop receiving water in distribution schemes face very high costs (eg Lower Mary $1,400/ML, Theodore $1,100/ML, other schemes around $500/ML). These fees must be reduced to encourage SunWater to reduce costs along with shifts in demand. Fees should also reflect the differential between shifting water from the distribution which may be at or below cost recovery to the river which is above cost recovery.

Recommendations: QCA review the following options:

- ***Reducing the fee by the margin that bulk charges are in excess of cost reflective tariffs.***
- ***Treating all distribution losses as a component of distribution water access entitlements (not bulk) and apply an exit fee if shifted.***
- ***Fixing the fee to extend beyond the new price path i.e. not allow SunWater to reset fees to a smaller customer base.***
- ***SunWater as a service provider to take a bigger share of the risk in the drop in the amount service required.***
- ***QCA to recognize through the termination fees that the service provider can play a large role in managing its own risk by optimization and marketing.***

4. Electricity costs

Rising electricity costs are a significant issue in a number of distribution schemes but a consultant report notes that electricity costs were substantially less than forecasts in schemes for the current price path. SunWater needs to be more transparent and accountable for these costs.

Recommendations: QCA examine the following options for their final report:

- ***Assess electricity costs for each scheme on actual recorded electricity bills before being converted into dollars per ML of meter use for the same period.***
- ***Bill actual electricity costs quarterly in arrears by tariff group or***
- ***Adjust variable tariffs quarterly per tariff group to account for actual over or under recovery of electricity costs***

5. Indirect and overhead costs

There are large differences in the data on indirect and overhead costs presented in consultant reports conducted for QCA. For example the QCA consultants Deloittes have assessed SunWater indirect and overheads for all sectors at 34% of total costs and confirmed that this is in accord with benchmarks derived from a range of utilities in Australia & overseas. However the average indirect and overhead costs for bulk irrigation schemes are 52% and for distribution schemes 40%. Overall indirect and overheads for SunWater irrigation schemes is 49% but it is only 25% for the other industry sectors of SunWater's operations. This raises the question as to whether the irrigation sector is funding a portion of the increasing costs to service the growth in mining and urban sectors. QCA recommends that SunWater improve its management accounting processes and procedures for its labour costs but this will do little to improve transparency in regard to indirect and overhead costs. Issues in regard to improving information on these costs and consultation with customers are addressed in item 7 below.

Recommendation: QCA assess indirect and overhead costs for bulk and distribution service contracts at 34% in keeping with the benchmarking conducted for a selection of utilities.

6. Renewals annuity

There have been large over budget spends on renewals for most channel and bulk schemes without adequate consultation with customers. QCA has undertaken a limited analysis of sampled projects and recommended removal or reduction of costs on some of these items because of SunWater's failure to adequately assess prudency and efficiency or provide sufficient information for analysis. For all non-sampled items QCA has applied a 10% saving. SunWater's overspend on renewals over the last five years has been passed onto growers but overspend of $15 million on electricity and over recovery of $10.5 million on revenue offsets has not. QCA has recommended SunWater undertake more analysis of renewals expected to occur over the planning period and the price path term. QCA also recommends that SunWater base their consultations on network service plans enhanced to include analysis of renewals as outlined above and annual updates. The added costs of this requirement will also have to be monitored closely. Scheme level consultation should be limited to proposed renewals spending over budget.

In addition, for schemes such as the Lower Mary for example, QCA consultant investigations have indicated that assets such as pump stations are well in excess of what is required to service demand. Planning for future renewal spends in distribution schemes need to be adjusted to take account of assets that substantially exceed demand and service requirements of the scheme. This issue is addressed under item 8.

Recommendations: QCA to review the following options:

- ***QCA conduct further analysis to explain how schemes identified as above lower bound in the current price path can face a negative or reduced renewals annuity.***
- ***Consultations should be conducted by SunWater with schemes for any proposed over spends in the renewals budget before the costs can be allocated to the scheme.***

7. Forecast costs

SunWater's forecast total costs are well above the targets for costs set for the current price path. The QCA draft report identifies the following significant differences between forecast and actual costs for the 30 service contracts from 2007 to 2011 in 2010/11 dollars:

- Operations $11.4 million or 16% less than forecast.

- Electricity $15 million or 36.7% less than forecast
- Preventive/Corrective Maintenance $8.8 million or 17% over spend
- Revenue offsets $10.5 million or 250% over recovery
- Indirect and overheads $17 million or 19% over spend
- Renewals annuity $30.9 million or 80% over spend

The end result sees the total of operations, preventive maintenance, corrective maintenance, indirect and overheads costs for 2011 (the last year) being $12 million or 33.5% above the budget forecast agreed to by SunWater. QCA proposes that SunWater should improve its information systems but unless detailed reasons can be provided for these significant variations it is hard to have any confidence in moving forward into another price path relying on information provided by SunWater. Differences between actual total costs and forecasts in individual schemes are also significant.

Recommendation: QCA assess SunWater's total costs on the forecast costs from the last price path until SunWater presents detailed data to explain the cost variations.

8. Scheme optimisation

All distribution schemes have been assessed at below cost reflective prices with some remaining well below cost reflective prices in 2016-17. These distribution schemes are expected to face difficulties achieving cost recovery targets given the expected burdens of further reform implementation and increasing SunWater costs over the new price path. QCAs recommended prices are unlikely to help distribution schemes to adjust for a number of reasons. For example, just allowing these schemes an extended period to achieve lower bound (which in some cases may be well in excess of the new price term) is unlikely to address adjustment problems. For some schemes like the Lower Mary and Dawson/Theodore, this approach raises significant uncertainty for customers and dependent industries regarding the longer term viability of the scheme. Also by setting the variable charge for schemes at average use QCA is penalizing users who consume water in excess of the average. QCA also has not been able to investigate opportunities to 'optimise' scheme assets and associated servicing standards to achieve greater efficiencies.

Recommendation: QCA review water use and availability in each distribution scheme as a basis for an assessment of what adjustments can be made to scheme assets and services to allow all distribution schemes to be able to recover costs moving into a new price post 2016-17.

9. Revenue offsets

QCA has failed to fully account for items of revenue to offset these against costs. For example a consistent approach for minimum charges for small users in the bulk and distribution segments and cost reflective charges for delivering bulk water through distribution system in most schemes. Also there has been above budget recovery of revenue during the current price path that has not been carried forward to be offset against cost blow outs.

In addition, the cost of delivering water to bulk customers through the channels has been established by using the IQQM model with an average requirement. The IQQM model was set up to establish water allocation entitlements and their reliability, not capacities of channels required to deliver them.

Recommendations:

- ***QCA review all revenue sources (minimum charges, use of distribution capacity, drainage charges etc) to ensure that all are allocated correctly and offset against costs.***
- ***QCA offset all revenue recovered above budget forecasts for current price paths against forecast expenditure***

10. Scheme consultation

QCA has made a number of recommendations in regard to improvements that Sunwater needs to make to scheme consultation. There are concerns that these recommendations will result in substantial cost increases without needed improvement in information about costs as a basis for effective consultation.

Recommendation: QCA require that SunWater cannot proceed with any cost item during the price path or later that is over budget costs assessed in accordance with QCA recommendations unless there has been formal consultation with customers.

11. Working capital

QCA has entered another cost item into this process called return on working capital. At this stage the cost to establish this cost item has exceeded the proposed revenue. All irrigation customers are billed 3 months in advance for all fixed costs removing any need for working capital.

Recommendation: There is no need for a return on working capital charge with quarterly bills paid in advance and the use of renewals annuity.

12. Market risk costs

Market Risks costs and renewals annuity costs pose a large risk for cost blow out if left without a strong consultation process in place with customers who have to pay the cost.

Recommendation: QCA to recommend that any new cost item that has not been identified and priced as part of this review will require consultation with customers before the item is priced against the scheme.